



Signed and Filed: February 18, 2015

A handwritten signature in black ink, appearing to read "Hannah L. Blumenstiel".

HANNAH L. BLUMENSTIEL  
U.S. Bankruptcy Judge  
UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re: ) Case No. 14-31532 HLB  
KINGSWAY CAPITAL PARTNERS, LLC, ) Chapter 11  
Debtor. )

**TENTATIVE RULING DENYING MOTION FOR RELIEF FROM STAY**

This matter comes before the Court on creditor Maria Sosa's Motion for Relief from Stay (the "Motion"). Debtor has opposed the Motion; Ms. Sosa has replied.

The parties do not dispute that relief from stay should be granted if Debtor is unable to assume the lease between the Debtor and Ms. Sosa dated January 16, 2013. The parties correctly cite to controlling Ninth Circuit authority for determination of the assumability of a lease. City of Valdez v. Waterkist Corp. (In re Waterkist Corp.), 775 F.2d 1089 (9th Cir. 1985); In re Windmill Farms, Inc., 841 F.2d 1467 (9th Cir. 1988). Waterkist outlines a two-part test for determining whether a lease can be assumed:

- 1) The court must determine if the lease terminated prior to the petition; and

1           2)    If it did, the court must determine if the  
2                    termination is reversible under state law.  
3 Waterkist, 775 F.2d at 1091.    The purpose of this test is  
4 straightforward:

5           This approach serves two purposes.   It prohibits the  
6           debtor-in-possession from using the bankruptcy process to  
7           assume a lease or executory contract which would not have  
8           been assumable absent the bankruptcy proceedings.   It also  
9           permits the debtor-in-possession the same opportunities to  
10          avoid forfeiture of a lease or executory contract that it  
11          would have received under state law absent the bankruptcy  
12          proceedings.   See Butner v. United States, 440 U.S. 48,  
13          55, 59 L. Ed. 2d 136, 99 S. Ct. 914 (1979) ("Property  
14          interests are created and defined by state law.   Unless  
15          some federal interest requires a different result, there  
16          is no reason why such interests should be analyzed  
17          differently simply because an interested party is involved  
18          in a bankruptcy proceeding." ).

19 Id.   If a nonresidential lease has terminated under state law,  
20 there is nothing to assume.   Windmill Farms, 841 F.2d at 1469.

21          Turning first to termination of the lease, under  
22          California law, a court should consider the lease terminated as  
23          of the filing of an unlawful detainer action if the following  
24          requirements are met:   (1) the landlord provided proper three  
25          days' notice to pay rent or vacate; (2) the lessee failed to  
26          pay rent during that period; and (3) the notice contained an  
27          election of forfeiture.   Id. at 1471.   The parties do not  
28          dispute that (2) and (3) have been satisfied.   Debtor has not  
29          paid rent since May 2014, satisfying prong (2).   In addition,  
30          the three days' notice contains the language:   "[i]n the event  
31          you fail [pay rent], legal proceedings will be instituted  
32          against you to recover possession of the premises [and] declare  
33          the forfeiture of the rental agreement or lease under which you

1 occupy the premises . . . .” This language is a valid  
2 declaration of intent to elect forfeiture that satisfies prong  
3 (3) of the Windmill Farms test. Neuhaus v. Norgard, 35 P.2d  
4 1039, 1041, 140 Cal. App. 735, 739-40 (1934). Therefore, the  
5 only dispute is whether or not Ms. Sosa provided proper three  
6 days’ notice.

7 Sufficiency of the three days’ notice is governed by  
8 section 1162 of the California Code of Civil Procedure. That  
9 section provides that, with respect to commercial leases,  
10 service of the notice may be made upon (1) the tenant  
11 personally; (2) if the tenant is absent, by leaving notice with  
12 a competent person at the premises, provided notice is also  
13 mailed; and (3) if a competent person cannot be found with due  
14 diligence, by affixing a copy of the notice in a conspicuous  
15 place on the property. Cal. Code Civ. Proc. 1162(c). Debtor  
16 challenges the sufficiency of service of the three days’ notice  
17 on three grounds: (1) since the property is owned by the Maria  
18 G. Sosa Trust, and not Ms. Sosa, the three days’ notice was  
19 ineffective; (2) Debtor was not properly served in a manner  
20 listed in section 1162; and (3) the commercial lease’s express  
21 requirement that notices be mailed in writing supersedes the  
22 statutorily authorized methods of service, and Ms. Sosa failed  
23 to comply with those contractual notice provisions.

24 Debtor’s first ground is not well-taken. While it appears  
25 that the property may be titled to the Trust, the lease  
26 identifies Ms. Sosa as lessor. As a party to the lease, Ms.  
27 Sosa is entitled to elect forfeiture. Further, as trustee of  
28 the Maria G. Sosa Trust, Ms. Sosa would have the authority to

1 take actions on behalf of the Trust, including sending notice  
2 pursuant to section 1162. Therefore, whether Ms. Sosa was  
3 acting on her own or on behalf of a principal is irrelevant;  
4 she would be the person responsible for initiating such a  
5 notice.

6 Turning to sufficiency of service of the three days'  
7 notice, there exists a dispute of fact. Ms. Sosa claims that  
8 she personally served Debtor with the three days' notice.  
9 Debtors' principal Mr. Sobayo disputes this fact, and claims  
10 never to have received the three days' notice by personal  
11 service. As valid service of the notice is a predicate to  
12 forfeiture, an evidentiary hearing is necessary for the Court  
13 to determine if service of the three days' notice was in fact  
14 proper. Windmill Farms, 841 F.2d at 1471.

15 Turning to the question concerning the satisfaction of the  
16 lease's notice provisions, Debtor argues an evidentiary hearing  
17 is not necessary since the commercial lease permitted only one  
18 form of service, which Ms. Sosa failed to use. The Court  
19 agrees. California courts have found that, in commercial  
20 leases, the landlord and tenant may agree to notice procedures  
21 that differ from those provided in section 1162. Culver Center  
22 Partners East #1, L.P. v. Baja Fresh Westlake Village, Inc.,  
23 110 Cal. Rptr. 3d 833, 836, 185 Cal. App. 4th 744, 750 (Cal.  
24 App. 2d Dist. 2010); Folberg v. Clara G. R. Kinney Co., 163  
25 Cal. Rptr. 426, 428-429, 104 Cal. App. 3d 136, 140-141 (Cal.  
26 App. 1st Dist. 1980)(parties to commercial lease may lawfully  
27 agree to notice provisions different from those provided in  
28 sections 1161 and 1162); 250 L.L.C. v. PhotoPoint Corp., 32

1 Cal. Rptr. 3d 296, 307, 131 Cal. App. 4th 703, 718 (Cal. App.  
2 1st Dist. 2005)(parties to commercial leases may waive rights  
3 under the civil code). If the lease contains service  
4 requirements for the notice to quit at variance with the  
5 requirements in the unlawful detainer statutes, the lease  
6 provisions control. Folberg, 163 Cal. Rptr. at 429.

7 The commercial lease provides: "[n]otices under this Lease  
8 shall not be deemed valid unless given or served in writing and  
9 forwarded by mail, postage prepaid, addressed as follows . . .  
10 Nathaniel Basola Sobayo, dba: Kingsway Capital Partners, LLC,  
11 P.O. Box 1052, Palo Alto, CA 94302." The lease goes on to  
12 state that the parties may change their respective addresses  
13 from time to time. There is no evidence in the record that  
14 service of the three days' notice was made in accordance with  
15 the parties' agreement; however there is direct evidence in the  
16 form of Mr. Sobayo's declaration, indicating that the three  
17 days' notice was never mailed to the address listed on the  
18 commercial lease. On this basis, it would appear service of  
19 the three days' notice was invalid. Accordingly, the Court is  
20 inclined to find that the lease did not terminate prior to the  
21 petition date.

22 Even if the Court were to find that the lease did  
23 terminate, the lease may still be assumed if the Court finds  
24 that Debtor would be entitled to relief from termination under  
25 state law. Debtor asserts that two statutes provide for such  
26 relief, California Code of Civil Procedure sections 1174(c) and  
27 1179. Debtor is half right. Section 1174(c) does not permit  
28 cure of a lease where a landlord has elected the remedy of

1 forfeiture. As noted above, the three days' notice provided by  
2 Ms. Sosa sufficiently indicates an election of forfeiture.  
3 Therefore, section 1174(c)'s cure remedy is not available.

4 However, the termination of a lease may still be unwound  
5 by section 1179. That section permits a court to relieve a  
6 tenant from forfeiture of a lease in order to avoid hardship.  
7 In determining whether the forfeiture of a lease would  
8 constitute hardship, California courts apply a balancing test,  
9 weighing the hardship tenant would suffer from forfeiture  
10 against the hardship the landlord would suffer if the lease  
11 were reinstated. Thrifty Oil Co. v. Batarse, 220 Cal. Rptr.  
12 285, 290, 174 Cal. App. 3d 770, 777 (Cal. App. 2d Dist. 1985).  
13 Factors the court should consider include the nature of the  
14 breach, the hardship to each party, the good faith of either  
15 party, the bad faith of either party, the degree of  
16 arbitrariness or unreasonableness on the part of the lessor,  
17 and any other relevant factors. Id. In the context of a  
18 bankruptcy case, hardship upon the estate may also be  
19 considered. In re FOOD RESOURCES, 1987 Bankr. LEXIS 204  
20 (Bankr. E.D. Cal. Feb. 3, 1987).

21 Debtor asserts several factors weigh in its favor. First,  
22 Debtor's current rent of \$1,750 per month is below market, and  
23 the cost of rent for comparable space in the area is now \$3,000  
24 to \$3,500 per month. Second, Debtor asserts its failure to pay  
25 was in good faith based upon its belief that Ms. Sosa was in  
26 breach of the lease for failure to make repairs. Ms. Sosa  
27 asserts that reinstatement of the lease would work an undue  
28 hardship upon her due to the pending sale of the property. Ms.

1 Sosa indicates that permitting the lease to be reinstated, and  
2 thus assumable, would cause her current sale to fall through,  
3 and make it impossible to find another buyer. Ms. Sosa asserts  
4 that this is a hardship because she is currently not in a  
5 financial position to continue ownership of the property.  
6 Finally, she asserts that the toxic relationship between her  
7 and Debtor would only worsen if allowed to continue.

8       Examining the relevant hardships, the Court believes that  
9 permitting the forfeiture to stand would cause greater hardship  
10 to the Debtor than reinstating the lease would cause to Ms.  
11 Sosa. The Court first looks at the nature of the breach.  
12 Generally, covenants to repair and to pay rent are considered  
13 dependent, and failure of the landlord to perform suspends the  
14 tenant's obligation to perform. See generally, Restatement  
15 (Second) of Property (Landlord & Tenant) § 7.1 (1977).  
16 California's Supreme Court has adopted this view with respect  
17 to residential leases. Green v. Superior Court of San  
18 Francisco, 517 P.2d 1168, 10 Cal. 3d 616 (1974). California  
19 appellate courts have repeatedly refused to apply Green in the  
20 context of commercial agreements, applying instead the common  
21 law independent covenant doctrine, which does not relieve a  
22 tenant of the duty to pay rent. Schulman v. Vera, 166 Cal.  
23 Rptr. 620, 625, 108 Cal. App. 3d 552, 560 (Cal. App. 4th Dist.  
24 1980); Custom Parking v. Superior Court, 187 Cal. Rptr. 674,  
25 679, 138 Cal. App. 3d 90, 97 (Cal. App. 1st Dist. 1982).  
26 Still, Debtor's breach is not due to an inability to pay, but  
27 instead a desire to compel Ms. Sosa to comply with the terms of  
28 the parties' bargain. If Debtor were to pay all back due rent

1 (as would be necessary in order to assume the lease under  
2 section 365 of the Bankruptcy Code), then Ms. Sosa would have  
3 the benefit of her bargain going forward. For this reason, the  
4 nature of the breach weighs in favor the Debtor.

5 Along these same lines, the Court is inclined to find that  
6 Debtor, although woefully misguided and at times hostile, has  
7 generally acted in good faith. While Debtor was in technical  
8 breach of the lease by not paying rent, Debtor's refusal to pay  
9 rent was motivated by Ms. Sosa's alleged failure to make  
10 repairs.

11 Ms. Sosa has not denied that she has a duty to make  
12 repairs. Nor has she denied allegations that the building  
13 suffered damage from rainfall, was leaking, and continues to  
14 leak. In fact, her pleadings impliedly acknowledge that she  
15 knew she possessed such a duty (Ms. Sosa asserts in her moving  
16 papers that her counsel informed Debtor of his obligation to  
17 pay rent despite her failure to make repairs). While Debtor's  
18 self-help may not be a permissible remedy under California law,  
19 he does not appear to be motivated by anything other than an  
20 effort to gain Ms. Sosa's compliance with the lease.

21 Further, Debtor would clearly suffer hardship from the  
22 forfeiture of the lease. The relocation of Debtor's business  
23 would be an expense to the estate, and at least temporarily,  
24 would result in a reduction of income to the estate. This  
25 works against both Debtor's interest, and the interests of  
26 Debtor's creditors.

27 Ms. Sosa's arguments are not as convincing. The lease  
28 expressly provides that "[t]he landlord will be responsible for



1 all repairs to the building, all appurtenant, inside and  
2 outside the property, which include all plumbing, electrical,  
3 roof, ceiling, and all fixtures." Further, the lease provides  
4 that "[i]f the Premises are partially destroyed by fire or  
5 other casualty to an extent that prevents the conducting of  
6 Tenant's use of the Premises in a normal manner . . . ." Ms.  
7 Sosa had a duty to repair the premises and she appears not to  
8 have done so. It seems unjust to permit a landlord to breach  
9 her obligation under a lease, and then evict a tenant when they  
10 attempt to compel compliance.

11 Given all of these factors, the Court is inclined to  
12 conclude that, even if the three days' notice were valid, a  
13 forfeiture of the lease would be a hardship on Debtor such that  
14 relief would be obtainable under California law. Given that  
15 the lease would not be deemed terminated, it would be assumable  
16 upon prompt cure by Debtor.

17 Accordingly, the Court is inclined to **DENY** the Motion. The  
18 Court invites the parties to e-mail Courtroom Deputy Ben Gapuz  
19 (benjamin\_gapuz@canb.uscourts.gov) to indicate whether they  
20 accept the tentative ruling. If both parties accept the  
21 tentative ruling, the Court will: (1) vacate the hearing on the  
22 Motion set for February 19, 2015; and (2) enter an order  
23 consistent with this tentative ruling. Regardless, the other  
24 hearings in this case set for February 19, 2015 will proceed as  
25 scheduled.

26 **\*\*END OF ORDER\*\***  
27  
28

Court Service List

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